VZCZCXYZ0004
PP RUEHWEB

DE RUEHVJ #0858/01 1091057
ZNR UUUUU ZZH
P 191057Z APR 06
FM AMEMBASSY SARAJEVO
TO RUEHC/SECSTATE WASHDC PRIORITY 3285
INFO RUEATRS/DEPT OF TREASURY WASHDC PRIORITY

UNCLAS SARAJEVO 000858

SIPDIS

SENSITIVE
SIPDIS

DEPT FOR EUR/SCE (FOOKS/RIEHL), EUR/ACE (VISOCAN), AND
EB/IFD/OMA (VOLK/YOUTH)
TREASURY FOR GAERTNER, OTA FOR JORSTAD
STATE PLEASE PASS TO USAID

E.O. 12958: N/A
TAGS: EFIN ECON PGOV BK
SUBJECT: BOSNIA PASSES LEGISLATION TO RESTRUCTURE WARTIME
DEBT TO DEPOSITORS

REF: 05 SARAJEVO 1599 AND PREVIOUS

¶1. (SBU) Summary: After more than two years of efforts (reftel), on April 13 Bosnia's state-level parliament approved legislation to restructure KM 1.9 billion of hard currency bank deposits seized by Belgrade during the war, just in time to meet a court-imposed deadline for a settlement. The law provides for cash payments of KM 1,100 for each frozen foreign currency holder over two years, which should satisfy in full the claims of over 70% of depositors. The balance will be restructured via a new USG-funded government securities market into bonds with a maturity of up to 13 years, bearing an interest rate of 2.5%. An amendment to calculate interest of 0.5% on deposits from the time of the war was accepted during the contentious five-hour session in the House of Representatives, a provision that could increase the cost of settlement by KM 140 million. Work will now begin to register and verify frozen foreign currency claims, a process that is expected to take nine months. Passage of this law is a major step forward in putting Bosnia on the path to long-term financial sustainability. In recognition of this significant progress, Moody's credit rating agency has signaled that it will likely upgrade Bosnia's B3 rating in the near future. End Summary.

Do-Over on Domestic Debt

¶2. (SBU) On April 6 of last year, the Human Rights Commission of the BiH Constitutional Court set aside large portions of IMF/OHR-drafted legislation to restructure Bosnia's domestic debt. In its ruling, the Court held that the entity-level laws, which provided for two different settlements, violated the right of BiH citizens to equal treatment. The Court declared that the bonds must be a marketable securities with "fair interest" (nixing OHR's proposed zero-interest bonds) and that depositors must be repaid within a maximum of 15 years. The Court decreed frozen foreign currency deposits to be an explicit responsibility of the state and gave the Government six months to draft a a new state-level law harmonizing the treatment of citizens across the territories.

¶3. (SBU) A state-led working group, with the assistance of the U.S. Treasury Debt Advisor, succeeded in producing a text that met the court's parameters. However, the draft stalled in the face of strong resistance from the former SDS-led government in the Republika Srpska (RS) which, despite the court ruling, opposed any issuance of state-level debt. The Court extended the deadline, but upped the ante by declaring that a court-imposed moratorium on these claims would expire

on April 17, 2006. This threatened to make frozen foreign currency claims -- all KM 1.9 billion of them -- fully enforceable by allowing depositors to intercept funds entering government bank accounts with only a court order (many of which have been issued already).

Out of Frying Pan, Into the Fire

¶4. (SBU) When the draft finally moved into parliamentary procedure, it was immediately attacked by frozen foreign currency holders, who demanded immediate and full repayment of their claims (with interest, naturally). Politicians, eyeing the upcoming elections, quailed in the face of the well organized and vociferous depositors and began rushing to propose better terms. Parliament's Budget and Finance Committee recommended rejection of the draft, seriously jeopardizing its chances of passage before the full parliament. In response, the Embassy embarked on a strong lobbying campaign. Embassy and U.S. Treasury staff met parliamentary Speakers, members of the Budget and Finance Committee, heads of factions, and other prominent parliamentarians to explain the consequences of failing to meet the Court's deadline and laying out, in graphic detail, the cost of various alternative proposals. Embassy staff also pushed the Minister of Finance Ljerka Maric, notably absent from discussions, to engage more vigorously in support of the law

¶6. (SBU) Parliament swiftly voted to send the law back to committee. After several difficult sessions and some minor amendments, including one to bring it into force the day after adoption rather than the customary seven days after publication in the Official Gazette, the draft was sent again to the floor with a positive report. Now fully cognizant of the impending fiscal meltdown, parliamentarians took the unusual step of scheduling a special session of both houses to consider the draft on April 13, where it was subjected to a contentious five-hour debate. In the end, parliament voted to approve the law, with one significant amendment from the floor: interest at the rate of 0.5% will now be added to deposits as of January 1, 1992. While this could conceivably increase the cost of the settlement by up to KM 140 million, the expectation is that verification will lower the total amount of claims.

Next Steps

¶7. (SBU) Work will now begin on registering and verifying claims. This process, expected to take approximately nine months, will be conducted by entity-level institutions under guidelines laid out in the new state-level law. The cash portion of settlement will be paid out over the next two years, with depositors receiving KM 100 following the verification of their claims and up to an additional KM 1,000 over the course of the next year. The balance will be restructured into bonds with a maturity of up to 13 years bearing an interest rate of 2.5% through the new USG-funded government securities market. The bonds will be serviced from the proceeds of the single account in a mechanism similar to that used for external debt, i.e. before being transferred to the entities. Work on the new market continues apace. Hardware has been delivered to the Central Bank and Ministry of Finance, software is in the process of being installed and training of staff involved in the new market has begun.

Comment

¶8. (SBU) Passage of the law represents a significant step forward for Bosnia's long-term financial sustainability. All successor countries of the former Yugoslavia had a problem with frozen foreign currency deposits, but the rest of the region resolved it long ago. Ten years after the war, only Bosnia had not managed to construct a solution due to its

weak institutions, limited technical skills and modest resources. Tapping the Single Account to service the debt, a U.S. Treasury suggestion, will ensure that depositors get their money. It will also increase the attractiveness of the securities for banks and foreign investors, increasing their market value. The creation of a state-level government securities market as the vehicle to restructure the debt will guarantee that the bonds are fully tradable. Depositors that cannot wait 13 years for full repayment will be able to sell their bonds through a transparent process, rather than to speculators on street corners (as happened during an earlier failed attempt to restructure the frozen foreign currency deposits through a voucher program). The settlement has already yielded its first positive result -- Moody's, in recognition of the law's passage, has signaled that it plans to upgrade Bosnia's debt rating (currently B3) in the near future. End Comment.
MCELHANEY